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In The

Supreme Court of the United States

October Term, 1992

JAMES JOHN CHICA,

Petitioner,

v.

JUDY LEE,

Respondent.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eighth Circuit

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF SECURITIES INDUSTRY ASSOCIATION, INC. IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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June 30, 1993

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MOTION OF SECURITIES INDUSTRY ASSOCIATION, INC. FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Pursuant to Rule 37.2 of the Rules of this Court, Securities Industry Association, Inc. (the "SIA") requests leave to file the accompanying brief as *amicus curiae* in support of the petition for a writ of certiorari (the "Petition"). Counsel for the petitioner has consented to the filing of this brief; counsel for the respondent has withheld consent.

The SIA is a trade association of over 650 securities firms in the United States and Canada that collectively account for approximately 90 percent of the securities

business conducted in North America. Over the past decade, there has been an enormous growth in the number of securities cases submitted to arbitration, with the result that the SIA's members now typically resolve their disputes with customers and employees in arbitration proceedings, rather than burdening the courts with such disputes.[1]

Just as the civil court system has in recent years experienced "an explosion in the frequency and size of punitive damages awards," *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032, 1066 (1991) (O'Connor, J., dissenting), however, there has also been a growing and disturbing trend of arbitration panels imposing extremely large awards of punitive damages against securities firms.[2] Such awards by arbitration panels are a matter of enormous concern to the SIA and its members and, if allowed to continue, could threaten the system of resolving such disputes in private arbitration proceedings rather than in the public court system. The decision

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[1] According to the General Accounting Office, "[i]n the past decade, the number of arbitration cases filed with the securities [self-regulatory organizations] has increased approximately 540 percent, from 830 in 1980 to 5,332 in 1990." United States General Accounting Office, *Securities Arbitration: How Investors Fare* at 18 (May 1992).

[2] A recent newspaper article identified four punitive damages awards in the amount of $1 million or more that were imposed by arbitration panels against securities firms in 1992, which included one award in the amount of $3.5 million. *Los Angeles Times*, at D3 (Jan. 17, 1993). The Petition notes that punitive damages awards totaling almost $30 million were issued in securities arbitrations during the period from May 1989 through June 1992. (Petition at 12).

below holding that punitive damages are available in arbitration proceedings therefore directly impacts the members of the SIA.

Accordingly, the SIA seeks to submit this *amicus curiae* brief to assist the Court in evaluating the public importance and practical consequences of the issues regarding the imposition of punitive damages in arbitration proceedings presented in the Petition. The SIA respectfully requests that its motion for leave to file the accompanying brief as *amicus curiae* be granted for that purpose.

Respectfully submitted,

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

Securities Industry Association, Inc. (the "SIA") is a trade association of over 650 securities firms in the United States and Canada that collectively account for approximately 90 percent of the securities business conducted in North America. The decision below – which sanctioned the imposition of punitive damages in a securities arbitration proceeding – presents a matter of enormous concern to the SIA and its members. Allowing the imposition of punitive damages in arbitration proceedings without adequate

procedural protections and meaningful judicial review threatens the private system of dispute resolution which has become the norm in the securities industry. The decision below holding that punitive damages are available in arbitration proceedings therefore directly impacts the members of the SIA.

A more complete description of the interest of the SIA in the punitive damages issue presented in the Petition is set forth in the accompanying motion for leave to file this brief as *amicus curiae* in support of the Petition.

ARGUMENT

The Petition should be granted with respect to its Questions Presented Nos. 1 and 2 concerning the availability of punitive damages in arbitration proceedings.[1]

[1] Questions Presented Nos. 1 and 2 state as follows:

1. Whether the enforcement of a punitive damages arbitration award against petitioner Chica, who was not a party to the arbitration agreement, violated Chica's due process rights where he was not afforded the procedural safeguards available in judicial proceeding and approved by this Court in *Pacific Mut. Life Ins. Co. v. Haslip*, 111 S. Ct. 1032 (1991).

2. Whether, in enacting the Federal Arbitration Act, Congress intended the federal courts to develop a federal common law of contracts preempting state law which reserves to the state the power to punish by punitive damages, thereby subjecting petitioner Chica to a punitive arbitration award prohibited by Minnesota law.

The SIA does not request that the Court grant the Petition insofar as it seeks review of Question Presented No. 3 concerning the enforceability of the arbitration agreement in question.

Review by this Court is necessary because the decision below sanctions the imposition of punitive damages in the absence of the due process procedural protections required by the Court in *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032 (1991). The Petition should further be granted because there is a split amongst the circuits concerning whether state or federal law governs the availability of punitive damages in arbitration proceedings.

I. THE IMPOSITION OF PUNITIVE DAMAGES IN ARBITRATION PROCEEDINGS VIOLATES DUE PROCESS.

The enforcement by the court below of the award of punitive damages against petitioner by an arbitration panel violated the Due Process Clause of the Fifth Amendment to the United States Constitution.

Punitive damages are not to be awarded " 'in proceedings lacking the basic elements of fundamental fairness.' " *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032, 1038 (1991) (quoting *Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 276 (1989)). Moreover, if punitive damages are imposed, due process requires "meaningful and adequate [judicial] review" of such awards. *Id.* at 1044.

In *Haslip*, the Court addressed the procedural safeguards necessary to satisfy due process requirements in considering a challenge to an award of punitive damages

by an Alabama jury.[2] The Court first noted that the seven criteria under Alabama law for evaluating awards of punitive damages "impose[d] a sufficiently definite and meaningful constraint on the discretion of Alabama fact finders in awarding punitive damages." 111 S. Ct. at 1045. Noting that both the trial court and the Alabama Supreme Court applied these specific criteria in scrutinizing the punitive damage award by the jury, the Court found that the defendant "had the benefit of the full panoply of Alabama's procedural protections." *Id.* at 1046. The Court concluded that such procedural protections satisfied the necessary due process requirements for an award of punitive damages. *Id.*

Securities arbitration proceedings – which were designed to secure the resolution of claims for compensation in a manner that is more expeditious and economical than that available in the court system – do not have the procedural protections necessary to satisfy the fundamental fairness standard required for the imposition of

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[2] This Court's recent decision in *TXO Production Corp. v. Alliance Resources Corp.*, 1993 Westlaw 220266 (U.S. June 25, 1993), does not alter *Haslip*'s holding that due process requires "meaningful and adequate judicial review" of awards of punitive damages. Indeed, each of the opinions issued in *TXO* recognized that due process requires *some* judicial review of punitive damages awards. *Id.* at 10 (Stevens, J., plurality); at 14 (Scalia, J., concurring); at 28 (O'Connor, J., dissenting).

punitive damages.[3] As Judge Beam noted in the dissenting portion of his opinion below:

> In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment. Discovery is abbreviated if available at all. The rules of evidence are employed, if at all, in a very relaxed manner. The factfinders (here the panel) operate with almost none of the controls and safeguards assumed in *Haslip*.

(Petition Appendix at 12-13) (hereinafter cited as "App. ___"). Such streamlined procedures facilitate the expeditious and economical resolution of disputes in an informal setting that allows lay persons to litigate their claims for compensation without the need for counsel. However, such procedures were not intended, and are not constitutionally adequate, to govern the imposition of punishment.

Moreover, as the decision below itself conceded, "judicial review of arbitration awards is narrowly limited and . . . an arbitration award will not be set aside unless it is completely irrational or evidences a 'manifest disregard for law.' " (App. 5); *see also* Federal Arbitration Act

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[3] The arbitration rules of the National Association of Securities Dealers, the New York Stock Exchange and the American Arbitration Association do not expressly address the issue of punitive damages. Accordingly, unlike the Alabama court system addressed in *Haslip* where awards of punitive damages are analyzed in light of seven criteria, arbitrators are not provided with any guidance regarding awards of punitive damages and the arbitration rules place *no* express constraints on such awards.

(the "FAA"), 9 U.S.C. § 10(a) (listing limited bases for challenges to arbitration awards). While such limited review advances the goal of resolving disputes concerning claims for compensation without lengthy appeals, the narrow scope of review in no way provides the "meaningful and adequate judicial review" necessary to satisfy due process requirements for the imposition of punitive damages established in *Haslip*.

More generally, in light of its punitive nature, the extraordinary remedy of punitive damages has no place in private arbitration proceedings which operate outside the public court system. "[P]unitive damages are quasi-criminal punishment." *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032, 1062 (1991) (O'Connor, J., dissenting). "For centuries the power to punish has been a monopoly of the State, and not that of any private individual." *Garrity v. Lyle Stuart, Inc.*, 386 N.Y.S.2d 831, 834, 353 N.E.2d 793, 796-97 (Ct. App. 1976) (citation omitted) (holding that New York law does not allow arbitrators to award punitive damages). Accordingly, the power to punish should be "confine[d] to the State and its courts. . . . " 386 N.Y.S.2d at 832, 353 N.E.2d at 795. Allowing arbitration panels, which operate outside the State's court system, to impose such punishment violates that fundamental principle.

In sum, a system that exposes litigants to punitive damages – a type of award that is qualitatively different from an ordinary award of compensation – must have a high level of procedural protection in order to pass muster under the Due Process Clause. Designed with the limited purpose in mind of facilitating the speedy and inexpensive resolution of claims for compensation, the

securities arbitration system does not provide the level of protection constitutionally required for the imposition of the unique sanction of punishment. The enforcement of the award of punitive damages against petitioner was therefore constitutionally invalid and should be vacated.

II. IN HOLDING THAT FEDERAL RATHER THAN STATE LAW GOVERNS THE AVAILABILITY OF PUNITIVE DAMAGES IN ARBITRATION PROCEEDINGS, THE DECISION BELOW IS CONTRARY TO THE DECISIONS OF OTHER CIRCUITS.

The Court should grant the Petition in order to resolve a split amongst the circuits regarding whether federal or state law governs the availability of punitive damages in securities arbitration proceedings. In disregarding the choice-of-law clause selecting Minnesota law and instead applying the FAA, the decision below is directly contradictory to the decisions of the Second and Seventh Circuits in *Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117, 122 (2d Cir. 1991), and *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334, 337-39 (7th Cir. 1984), respectively.[4]

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[4] As the Petition notes, other circuits have utilized the analysis applied in the decision below and similarly held that arbitrators may award punitive damages despite choice-of-law clauses selecting the law of states which prohibit such awards. (Petition at 23). *See Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1062 (9th Cir. 1991); *Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6, 11 (1st Cir. 1989); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1387 (11th Cir. 1988).

The arbitration clause at issue specifically provided that "[t]his agreement and its enforcement shall be governed by the laws of the State of Minnesota." (App. 3). Despite this clear language, the decision below determined that federal law – not state law – governed the availability of punitive damages. (App. 10). Concluding that the FAA required application of the rules of the American Arbitration Association and that those rules authorized awards of punitive damages, the decision below rejected petitioner's challenge to the award. (App. 9-10).

The Second Circuit has rendered a directly contradictory decision on this precise issue in vacating an award of punitive damages by an arbitration panel. *Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117, 122 (2d Cir. 1991). Much like the present case, *Barbier* involved an arbitration agreement with a choice-of-law clause that provided that "[t]his agreement shall . . . be governed by the laws of the State of New York." *Id.* Following this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989), the Second Circuit held that the availability of punitive damages was governed by New York law, which prohibits arbitrators from awarding punitive damages. 948 F.2d at 122 (citing *Garrity v. Lyle Stuart, Inc.*, 386 N.Y.S.2d 831, 353 N.E.2d 793 (Ct. App. 1976)). The Second Circuit therefore applied New York law and ruled that the arbitrators in question exceeded their authority in awarding punitive damages. *Id.* The Seventh Circuit similarly ruled in *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334, 339 (7th Cir. 1984), that an arbitration agreement containing a New York choice-of-

law clause prohibited arbitrators from awarding punitive damages.[5]

These decisions properly follow the guidance of this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989). In *Volt*, this Court held that the FAA did not preempt the parties' choice of California law, which provided for a stay of arbitration pending the outcome of related litigation. *Id.* at 470. The Court explained that the FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Id.* at 478. Consistent with that approach, the Court noted that the FAA "does [not] prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. . . . " *Id.*

Accordingly, under *Volt*, the Minnesota choice-of-law provision in this case should have been applied with respect to the availability of punitive damages. Like New York law, Minnesota law does not authorize arbitrators to award punitive damages.[6] Minnesota law provides that

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[5] More recently, a district court applied the Seventh Circuit's decision in *Pierson* in vacating an award of punitive damages by an arbitration panel when the arbitration agreement contained a New York choice-of-law clause. *See Mastrobuono v. Shearson Lehman Hutton Inc.*, 812 F. Supp. 845, 846-48 (N.D. Ill. 1993).

[6] As the Petition notes, courts in New Mexico and Indiana have also ruled that punitive damages may not be awarded in arbitration proceedings. (Petition at 19 n.4). *See Shaw v. Kuhnel & Assoc., Inc.*, 102 N.M. 607, 698 P.2d 880, 882 (1985) (holding that "power [to award punitive damages] is reserved to the courts"); *United States Fidelity & Guaranty Co. v. DeFluiter*, 456 N.E.2d 429,

punitive damages are available only in "civil actions." Minn. Stat. § 549.20 subd. 1(a). Under Minnesota law, "actions" do not include arbitration proceedings. *See Lucas v. American Family Mut. Ins. Co.*, 403 N.W.2d 646, 650-51 (Minn. 1987) (holding that arbitration proceedings are not "actions" under prejudgment interest statute). Therefore, the decision below erred in not applying Minnesota law and vacating the award of punitive damages by the arbitration panel.

Numerous circuits have addressed the interaction between the FAA and state choice-of-law clauses in arbitration agreements in determining the availability of punitive damages in arbitration proceedings and have reached entirely contradictory results. This split amongst the circuits on this important issue, and the resulting uncertainty, requires definitive resolution by this Court and mandates that the Petition be granted with respect to the issue of the availability of punitive damages in arbitration proceedings.

CONCLUSION

For the foregoing reasons, and for those set forth in the Petition, this Court should grant the Petition with respect to the Questions Presented Nos. 1 and 2 in the

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432 (Ind. App. 1983) (holding that "punitives are unavailable because parties may not contract to benefit from or be penalized by punitive damages").

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